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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Jan. 30, 1981

Two events highlighted the week in the financial markets: the rapid drop in the Federal funds rate and the demonstrated sensitivity of market participants to supply pressure from new issues in the intermediate- and long-term sector.

Though the funds rate drop was dramatic, it was almost certainly not the result of an overt move by the Federal Reserve to put the rate down to a lower level. Rather, the pattern of the Fed's reserve-draining operations strongly suggests that the Fed was doing what it says it does: keeping nonborrowed reserves on a growth path consistent with the annual targets for money growth. The remarkable thing was not that the funds rate declined but that it stayed in the 19%-20% range for as long as it did while the volume of borrowing from the discount window was reduced sharply in recent weeks. The drop coincided with a seasonal change in the reserve needs of the banking system. In previous weeks, the Fed had to supply substantial amounts of reserves to meet seasonal needs; but in the statement week ended on Wednesday, the pattern reversed, and substantial draining of reserve excesses became necessary. While the open market operations themselves were for the most part routine, the psychology of funds traders was affected significantly. As had been suggested here several times in recent weeks, banks became less aggressive in bidding for funds, and the result was a softening funds rate, despite the Fed's draining of reserves. Some further near-term declines in the funds rate are possible, as the seasonal reserve excess should continue for at least another week.

The FOMC meets next week against a background of generally stronger than expected economic activity, with indications of a slowdown only beginning to emerge. Since inflows into NOW accounts are making interpretation of M-1A and M-1B almost impossible (though some preliminary survey data on the sources of NOW inflows will probably be available in time for the meeting), the committee will probably put more weight on M-2, which is not materially distorted by the shift to NOWs. M-2 has been growing near the top of its target range. In this setting, the committee probably will vote to leave its path of reserves provision essentially unchanged. For now, a cut in the discount rate appears unlikely.

The market's reaction to the Treasury's Wednesday announcement of its quarterly refunding next week illustrates the sensitivity of the long-term market to supply pressures. The price of the long bond promptly dropped about a point, lifting its yield by about 10 basis points. The reason is that not only is the refunding large at $8.5 billion, but $2.25 billion of long-term bonds are being offered, the first time the offering of that maturity has exceeded $2 billion. Add to that an awesome visible supply of corporate issues, and the skittish behavior of bond market participants is readily understandable. The potential congestion of new issues need not mean higher bond rates, but it does suggest that in the near term declines in bond rates will be hard-fought.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	1/30/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.00%	20.00%	15.25%
Effective since	1/9/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	12.00
Federal Funds	17.25	18.75	13.38
Repurchase Agreements	16.50	18.25	12.38
U.S. Treasury Issues			
Bills			
3 months	15.45	16.44	12.60
6 months	15.00	15.94	12.82
1 year	14.00	14.63	12.42
Coupons			
2 years	13.25	13.68	11.81
4 years	12.95	13.14	11.20
7 years	12.75	12.84	11.20
10 years	12.70	12.79	11.14
Long Bond	12.30	12.35	11.12
Negotiable Certificates of Deposit-Secondary Market			
1 month	16.80	18.50	13.15
3 months	16.75	17.85	13.40
6 months	15.90	16.45	13.55
1 year	14.85	15.25	13.20
Banker's Acceptances			
1 month	17.00	18.10	13.20
3 months	16.60	17.85	13.50
6 months	16.05	16.40	13.60
Eurodollar Deposits			
1 month	17.63	19.00	13.94
2 months	17.50	19.13	14.19
3 months	17.38	18.75	14.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	16.00	16.00	12.00
1 month	16.25	17.50	12.25
3 months	15.75	16.50	13.00
Bank Holding Companies			
1 month	16.50	17.75	13.05
Dealer Placed:			
3 months	16.00	14.00	13.25
New AA Corporate Utility Bond	15.00	14.75	12.50
Tax Exempt			
6 month Project Notes	7.25	7.55	5.70
1 year AAA Bond	7.00	6.85	NA
5 year AAA Bond	7.15	7.00	NA
20 year AAA Bond	9.20	9.15	7.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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